

STATE OF CALIFORNIA
ELECTRICITY OVERSIGHT BOARD



Gray Davis, Governor

June 5, 2002

Hon. Pat Wood III, Chairman
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

Re: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000

Dear Chairman Wood:

I am writing to assist in the Commission's current investigation of manipulation in the California energy markets. The California Electricity Oversight Board (CEOB) appreciates the fact that the Commission has initiated this investigation into price manipulation of the electricity and natural gas markets through trading practices such as those revealed in the Enron memos.

The existence of such trading practices is no surprise to the CEOB and should be no surprise to the Commission. The CEOB, the California Independent System Operator Corporation (CAISO) and the California Power Exchange Corporation (CalPX) have, at various times, informed Commission staff of such practices. That said, the Commission did an important public service when it made the memos public because they allow the public to better understand the abusive strategies and philosophies without the need to interpret complex sets of market data. I urge you to continue the practice of making key materials public, including generally the responses to the Commission staff's investigative questions.

Along with appreciation for the Commission's efforts to date, I must also express real concern over the current scope of the Commission's inquiry. Following the disclosure of manipulative trading behavior by several companies, the Commission staff has appropriately made inquiries to other sellers. However, these questions have been drawn very narrowly to mirror the exact circumstances described in the company documents. As a result, some questions are inherently unlikely to apply to many sellers even though

the general practice being discussed may well apply. An example is the subject of “megawatt laundering,” one variation of which was described in the Enron memos as the “ricochet” game. The Commission staff’s query to other sellers regarding megawatt laundering includes in its definition that the power is purchased day ahead through the CalPX before being scheduled for export and then re-import. While such a practice would make sense for a company like Enron that does not own or control in-system generation in California, it is not the likely megawatt laundering strategy for a company that does have its own generation. By incorporating such an artificially narrow definition into its interrogatory, the Commission staff is allowing companies who may have engaged in megawatt laundering under the more commonly held meaning to respond that they did not launder.

Similarly, in the wake of revelations regarding “wash trades,” the Commission staff issued a request for admission regarding this practice. Unfortunately, it again appears that the question posed is unduly narrow. While it does require a company to disclose and explain instances where it engaged in exactly simultaneous and mirror-imaged trades, it makes no inquiry at all as to just slightly more sophisticated trades that may have been conducted for the same purpose and to the same effect.

I am among those encouraged by recent statements from you and others at the Commission promising that the investigation will be rigorous. Assuming this is the Commission’s intended outcome, I am attaching a list of questions (identified as Attachment A) that the CEOB believes should be asked of each seller during the early course of a thorough investigation. I am providing these out of a strong desire to work cooperatively with the Commission. This letter together with the Attachment A are also being filed with the Secretary in Docket No. PA02-2.

I hope that my comments, and the attached questions, will assist the Commission’s investigation.

Sincerely,

Erik N. Saltmarsh
Chief Counsel
Electricity Oversight Board

C.c.: Commissioner William L. Massey
Commissioner Linda K. Breathitt
Commissioner Nora Mead Brownell
Hon. Senator Dianne Feinstein
Hon. Senator Barbara Boxer

ATTACHMENT A

California Electricity Oversight Board Recommended Questions To Sellers in Investigation of Potential Market Manipulation

Evasion of price mitigation / megawatt laundering

1. Has the Company (“Company” is defined as the entity, including its employees and agents, upon which these questions have been served or as listed in Exhibit 1 attached hereto, and includes its affiliates (as defined in 18 C.F.R. § 161.2 (2001) and *The Power Company of America, L.P.*, 79 FERC ¶ 61,067 at 61,325 (1997)) and subsidiaries in the U.S. portion of the WSCC and/or Texas during the years 2000 and 2001) ever scheduled the export of power from the California Independent System Operator (CAISO) control area for the purpose of facilitating a subsequent import and sale of power, whether through “parking” of the export power, delivery to another entity for re-import, or exchange of the export power for replacement power intended for import? If so, please provide complete details of each such instance of such transactions, including whether the resulting sales were made at prices in excess of the caps otherwise then in effect in the CAISO markets.

Exercise of market power to raise prices (economic and physical withholding)

2. Has the Company ever bid the power output of one or more generating units (including on a portfolio bidding basis,) such that the submitted bids or bid curve did not offer to supply each increment of power into the market whenever the market price exceeded the marginal production cost of the increment but rather offered some or all increments of supply only at market prices significantly higher than the production cost of that increment? If so, please provide complete details of each such instance.
3. Has the Company ever engaged in a practice of bidding the power output of one or more generating units into the markets of the California Power Exchange (CalPX) and/or CAISO such that the bids for supplying increasing volumes of energy increased in price more steeply than the change in underlying costs for increasing output.
4. Has the Company ever engaged in bidding the production output of one or more generating units (individually or as a portfolio) such that the price(s) at which the same increment(s) of production was offered to the CalPX or CAISO was substantially higher during some hours or days than for other hours or days for any reason other than a change in the underlying marginal cost of producing energy from that increment of generating capacity? If so, please provide complete details of each such instance.

5. Has the Company ever engaged in a practice whereby bids for the power output of one or more generating units were raised in response to changes in system conditions that did not significantly affect production cost such as, but not limited to, a transmission line derate or outage of other generation units? If so, please provide complete details of each such instance.
6. Has the Company ever had generating units running at levels between minimum and maximum loading for which it submitted adjustment bids where the incremental bids significantly exceeded incremental marginal costs or the decremental bid was significantly less than the incremental net avoided cost of making the adjustment? If so, please provide complete details of such instance.
7. Has the Company ever reported generating capacity to the CAISO as operationally unavailable based on any economic or business reason(s) rather than due to physical inability of the capacity to operate?
8. Has the Company ever had generating capacity physically available and operationally uncommitted for which it declined to submit a bid to the CAISO for real time dispatch? If so, please provide complete details of each such instance.
9. Has the Company ever received a dispatch instruction from the CAISO and declined to fully comply with that instruction? If so, please provide complete details of each such instance.

False or infeasible scheduling

10. Has the Company ever submitted a schedule to the CAISO in which the Company, through any of its employees or agents, knowingly misstated the amount of power that it anticipated it would actually cause to flow on the grid?
11. Has the Company ever submitted a schedule to the CAISO which the Company, through any of its employees or agents, knew to include load that did not exist or for which the company was not the responsible scheduling coordinator or retail load serving entity? If so, please provide complete details of each instance of under or over stating the amount of power and/or load.
12. Has the Company ever submitted a schedule to the CAISO which the Company, through any of its employees or agents, knew to be infeasible, i.e. a schedule that calls for delivery of power in excess of known physical limitations of the transmission grid or the capacity of the Company's available resources? If so, please provide complete details of each instance of submitting infeasible schedules.
13. Has the Company ever submitted a schedule to the CAISO for the purpose of causing forward schedule congestion that they CAISO would have to relieve?

Sham sales; manipulative wash sales or swaps

14. Has the Company ever sold electric power or capacity into the CalPX markets or to the CAISO at a time when the Company did not own or control sufficient power or uncommitted capacity to fully deliver the product sold? If so, please provide complete details of each such instance.
15. Has the Company engaged in exchanges or swaps of power, power futures, or power derivatives in a manner that was substantially an exchange of equivalent products or rights rather than a net purchase or sale and that would have the effect of:
 - A. Altering the volume, margin, or average price of transactions reported to the FERC;
 - B. Altering prices of an index of reported trades;
 - C. Increasing the cost basis the company could claim with respect to a later sale.